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Agenda Item 4b(1)

May 16, 2011

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. **SUBJECT:** Adoption of Delegation Resolution for Real Assets
- II. **PROGRAM:** Real Assets
- III. **RECOMMENDATION:** Recommend to the Investment Committee Adoption of the Delegation Resolution for Real Assets
- IV. **ANALYSIS:**

Background

In December 2010, the Investment Committee (“Committee”) approved an alternative asset classification as part of the overall Strategic Asset Allocation process. The approved classification called for the creation of a new Real Assets class comprised of the Real Estate program, and the Infrastructure and Forestland programs from the Inflation-Linked Asset Class. Additionally, in February 2011, the Committee approved a new Strategic Plan for Real Estate.

In March 2011, staff developed a single overarching Real Assets policy to govern the consolidated program. Attachments to the policy are utilized for the Real Estate, Infrastructure, and Forestland programs. Staff also revised the Real Estate policy to reflect the approved new Strategic Plan for the program. The Investment Policy Subcommittee approved the proposed Real Assets policy in April 2011 for recommendation to the Committee in May 2011.

Staff is presenting this proposed *Delegation Resolution to the Professional Staff* (“Delegation”) for Real Assets to the Committee concurrent with the Policy Subcommittee approved proposed Real Assets policy. The proposed Delegation consolidates delegated authority to the CIO and SIO-Real Assets for the Real Estate, Infrastructure, and Forestland Programs under one document. Staff worked collaboratively with the Investment Strategy Group, Board Program Consultants, and the CalPERS Legal Office to solicit feedback and comments on the proposed Delegation. The General Pension Consultant, Wilshire Associates (“Wilshire”); Board Real Estate Consultant, Pension Consulting Alliance (“PCA”); and Board Infrastructure Consultant, Meketa; have reviewed the proposed Delegation and opinion letters are included in attachments as listed below.

List of Attachments

- Attachment 1 – Proposed and Current Program Delegations, Illustration Matrices
- Attachment 2 – Proposed Real Assets Delegation
- Attachment 3 – Wilshire Opinion Letter
- Attachment 4 – PCA Opinion Letter
- Attachment 5 – Meketa Opinion Letter
- Attachment 6 – Guidelines for Delegating Investment Authority

Overview of Additions/Changes to Program Delegations

As mentioned previously, the main purpose of the proposed Delegation is to consolidate the Real Estate, Infrastructure, and Forestland program delegations into a single document and effectuate revisions necessary to implement the new approved Strategic Plan in Real Estate. Additions and changes to the Infrastructure and Forestland program delegations are largely administrative with substantive changes detailed below. An overview of proposed Delegation additions and changes follows:

Real Estate

The approved Real Estate Strategic Plan (“Plan”) bifurcates the overall Portfolio into a new Strategic Portfolio and Legacy Portfolio. The Strategic Portfolio is further sub-divided along the risk continuum into the Base Core (Core), Domestic Tactical (Core, Value Add, and Opportunistic), and International Tactical (Value Add and Opportunistic) sub-portfolios. The Plan calls for fewer, larger strategic partnerships with a new emphasis on stable, income producing Core assets. In order to implement the Plan, and considering that the Real Estate Program is currently under-allocated compared to its target allocation, staff is recommending that delegated authority for new investments be increased along the risk continuum. As such, the proposed Delegation:

1. Increases delegated authority for new investments in the Strategic Portfolio along the risk continuum, and
2. Increases Annual Delegation Limits for new investments to implement the Plan and allow staff to bring the overall portfolio up to its target allocation, and
3. Increases the Maximum Relationship Exposure limits minimally in the Base Core portfolio (20% to 25%), and Domestic Tactical portfolio (10% to 15%) to accommodate the goal of fewer, larger strategic partnerships, and
4. Establishes absolute dollar limits in all individual transaction categories and Annual Delegation Limits that set a ceiling on dollar amounts the CIO

and SIO-Real Assets have authority to commit to a transaction or in sum with respect to the Annual Delegation Limits.

Staff also recommends maintaining and slightly increasing delegated authority related to managing existing investments in the overall Portfolio. Given the challenging market environment and a need to make investment decisions on a timely basis for existing investments, staff recommends:

1. Maintaining and slightly increasing delegated authority for additional investment to existing investments including the authority to borrow new money or allocate new equity and commitments to existing projects, and
2. Maintaining delegated authority for managing debt financing of existing investments that includes authority to retire debt early and renew or extend loans to existing projects, and
3. Maintaining Annual Delegation Limits for both of the additional investment and debt financing delegations described in (1) and (2) above, and
4. Establishing absolute dollar limits in individual transaction categories and Annual Delegation Limits that set a ceiling on dollar amounts the CIO and SIO-Real Assets have authority to commit to a transaction or in sum with respect to the Annual Delegation Limits.

Staff will continue to report quarterly to the Committee on actual allocation totals made to new and existing investments compared to the Annual Delegation Limits in all categories. Staff will also continue to report to the Committee on actual Maximum Relationship Exposures compared to the limits in all applicable categories.

Infrastructure

Changes to the Infrastructure Program delegations are largely administrative to facilitate consolidation into the new Real Assets Delegation. Staff is scheduled to propose comprehensive policy revisions for the program to the Policy Subcommittee in June and will follow with proposed necessary substantive Delegation changes in the third quarter 2011. For the current proposed Delegation, substantive changes to the Infrastructure program are limited to:

1. Increasing the absolute dollar caps for all Annual Delegation Limits by a factor of 1.33 (2.0/1.5) to reflect the increase of the Infrastructure target allocation from 1.5% to 2.0% of Total Fund value, as established in the approved December 2010 Strategic Asset Allocation process.

Staff will continue to report quarterly to the Committee on actual allocation totals made to new and existing investments compared to the Annual Delegation Limits in all categories. Staff will also continue to report to the Committee on actual

Maximum Relationship Exposures compared to the limits in all applicable categories.

Forestland

In the Forestland Program, staff is recommending that delegated authority for new and additional investments be increased slightly to allow for effective management of the Forestland assets. As such, the proposed Delegation:

1. Increases delegated authority for new investments, and
2. Increases delegated authority for additional investment to existing investments, and
3. Establishes Annual Delegation Limits with absolute dollar caps for new and additional investments, including the authority to retire debt early and renew or extend loans to existing investments.

Staff will continue to report quarterly to the Committee on actual allocation totals made to new and existing investments compared to the Annual Delegation Limits in all categories.

Role of Consultants

The roles of Board Investment Consultants and Investment Pool Consultants in the investment decision-making process for the respective Real Estate, Infrastructure, and Forestland Programs have been detailed in the Delegation to reflect the revised roles per the proposed Role of Private Asset Class Board Investment Consultants policy scheduled to go to the Policy Subcommittee in June 2011 for second reading and approval.

Consultant Concurrence

The Board Investment Consultants, Wilshire, PCA, and Meketa have reviewed and concur with staff's recommendation. Representatives will be available to respond to any questions of the Committee.

Implementation Timeline

Additional items require completion upon adoption of the proposed Delegation. The following timeline outlines the steps staff is proposing to complete and effectuate the Real Assets Delegation:

Implementation Action	Expected Timing
A. Staff submits PSC approved proposed Real Assets policy to IC.	May 2011
B. Staff submits proposed Real Assets Delegation to IC for review and approval.	May 2011
C. Staff submits proposed revised Infrastructure policy to PSC.	June 2011
D. Staff submits PSC approved revised Infrastructure policy and necessary Delegation changes to IC for review and approval.	Third Quarter 2011
E. Staff develops and proposes revised private markets Delegation Resolution template to streamline and simplify delegation process.	Second Half 2011
F. Staff updates IC on progress toward implementation of component program strategic plans and compliance with policy.	Quarterly

Delegated Authority Guidelines

In November 2006 the Committee adopted the *Guidelines for Delegating Investment Authority* (For your reference, *Guidelines* are included as Attachment 6), which addresses the role of the Board with respect to delegations and sub-delegations and are designed to provide guidance and consistency in granting authority.

V. STRATEGIC PLAN:

The proposed Real Assets Delegation will further the following CalPERS Strategic Plan goals:

- Goal VIII. Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.
- Goal IX. Achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

At this time the Investment Office does not anticipate any additional cost needed to implement the proposed Real Assets Delegation.

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